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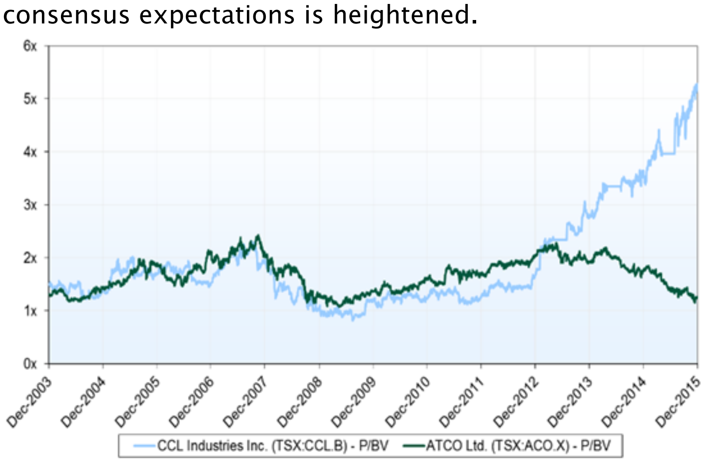
Survey Says...

Investors are nervous. On Wednesday, the CFA Institute, a global association of investment professionals, released findings that revealed 30 percent of retail and institutional investors feel another financial crisis is likely within the next three years. It seems clear, even without the survey, that investors are increasingly anxious about global markets.

As we progress through fourth quarter and fiscal year-end reporting for most businesses, investors have a lower tolerance for earnings misses and weak outlooks. For instance on February 4th LinkedIn Corp., the professional networking site, reported its biggest ever earnings loss along with an indication of decelerating revenues over time. LinkedIn's stock price dropped 50 percent over the next few days. Other businesses with similar high growth expectations began to experience double-digit share price declines in LinkedIn's wake. As is typically the case, companies trading in excess of 70.0x earnings have little room for error when executing on growth.

Though the stock pressure on Canadian high growth businesses has been less pronounced, the outcome has been similar. Investors continue to shift cash into higher quality companies with stable earnings growth that are perceived to be safer. In effect, the valuations of these businesses expand and the risk of having to beat consensus expectations is heightened.



Source: S&P Capital IQ

The chart above shows the price-to-book values of CCL Industries, a specialty label manufacturer, and ATCO, an Alberta based gas and electric utility. Both, in our view, are high quality businesses.

CCL's valuation has reached historic highs on account of tremendous growth over the past three years. The pressure is now on for CCL's growth to continue. ATCO's valuation, on the other hand, has fallen near historic lows despite its visible future prospects. Investors' fears of resource and Alberta-related businesses have provided QV an opportunity to take a maximum six percent weight in a well-managed franchise, with what we feel is minimal valuation risk. We don't need ATCO to exceed analysts' forecasts; we would simply like to see it grow as consistently as it has over the past 20 years.

Another revelation from the CFA survey is that "only half of all investors believe their investment firms are well prepared to manage their portfolio through a crisis." It is less of a surprise and more of a concern that trust in managers is low at a time when it should be high.

At QV, each of us is invested alongside our clients in the strategies that we manage. The decisions we make for our clients are the same prudent decisions we would accept for ourselves. Furthermore, QV maintains a defensive posture across its portfolios. In the QV Canadian Equity Strategy, this includes overweight exposure to utilities and consumer staples.

In seeking out opportunities in today's market, there are few sectors outside of energy, materials, and financials that offer compelling valuation relative to that of the overall S&P/TSX Composite Index. While these areas are cheap on a price-to-book basis, clients should not expect us to revamp the portfolio with cheap cyclical businesses. We will remain defensively positioned to preserve capital through the tough times. But we stand ready to deploy cash when disconnects between growth and valuation occur, such as the case with ATCO.

The worst thing we could do when fear is high is abandon our investment and risk management processes. They have kept our performance consistent over time, and demonstrate to our clients that we are prepared to navigate an uncertain market.